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DOW THEORY LETTERS

"The Market as Interpreted under the Dow Theory"

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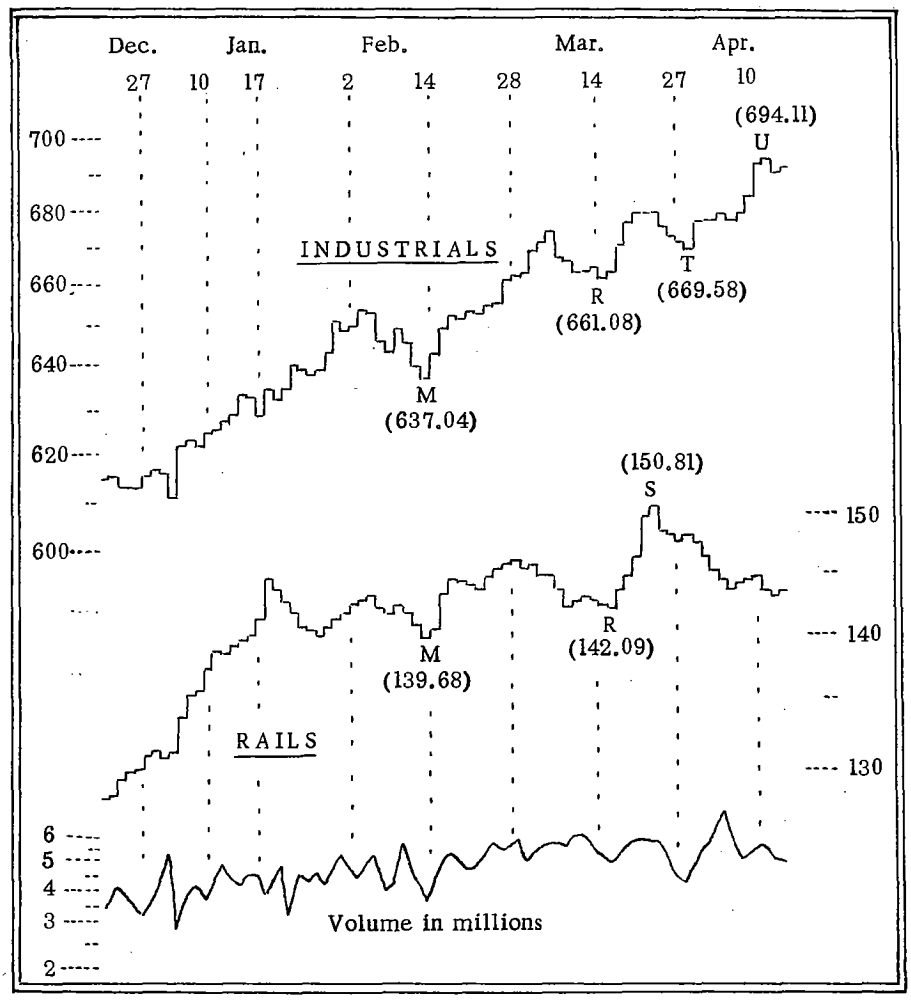
PRICE MOVEMENTS A principle of Dow's Theory states that a trend, once established, is taken to continue until proved otherwise. In determining the trend it is essential that the movements of both Averages be considered at all times.

The performance of the Rail Average over the last few weeks has been poor but not hopeless. Following the high at S (150.81), Rails declined steadily, forming two descending zig-zags in the process and closely approaching their preceding decline low at R (142.09). On the other hand, Industrials have shown strength. On April 10 the Industrial Average bettered its all-time peak of 685.47, and April 11 saw the senior Average close at an historic high of 694.11.

If Rail weakness continues, the burden of proof as to whether the market is weak or strong will fall to Industrials. As long as Industrials hold above their last decline point at T (669.58), then regardless of further possible Rail weakness the secondary trend will continue to be classified as bullish. A Rail penetration of R (142.09) or M (137.68) would be meaningless unless confirmed by important weakness in the Industrial Average.



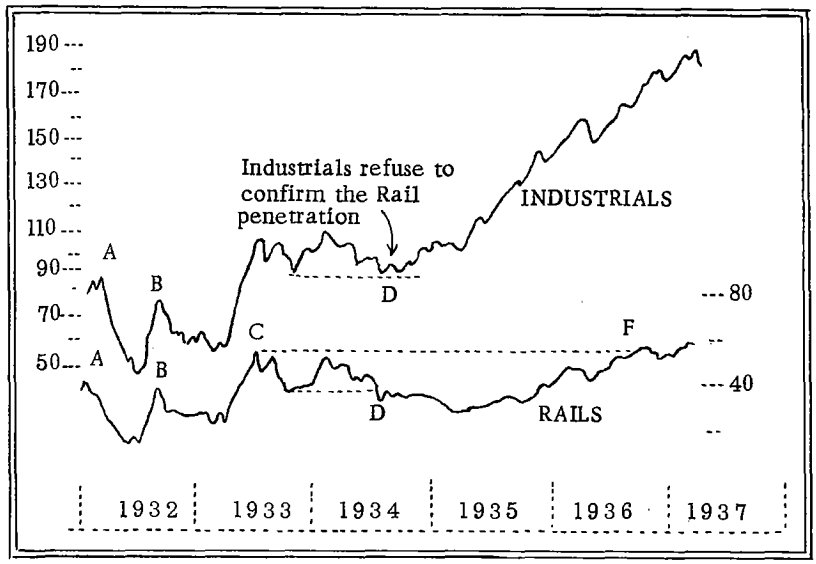
On April 12 and 13 the market evinced declining tendencies as volume dropped to 4.87 and 4.77 million shares respectively. The consistent contraction of volume with lower prices suggests that (so far) there is no overhanging supply of stock to be liquidated.

Odd-lot ratios (see Letter 138)on those two days moved further to the selling side, while odd-lot short sales on April 13 rose above 3,000 for the first time since February. Both of these indications must be taken constructively.

CONFIRMATION A great deal of misunderstanding exists regarding the confirmation principle. When the two Averages confirm each other by penetrating preceding points the implications are always positive. In other words,

confirmation ordinarily implies that a movement will continue in the direction of the penetration. However, non-confirmation can never be positive, it can only have negative implications. For instance, if one Average penetrates a preceding decline point and the other Average persistently refuses to confirm, we can say that the bearishness of the downward penetration is negated or open to question. We can go further and say that there is a good chance of a reversal of trend. But we cannot say that the non-confirmation is definitely bullish.

Exactly this occurred on October 24, 1960, when Industrials plunged below their preceding September 28 low while Rails refused by 14 ¢ to confirm. The bearish penetration of Industrials was negated by the Rail's refusal to confirm, but under Dow Theory, we could not state that the refusal of Rails to confirm was positively bullish. Letter 121 (October 27, 1960) did state: "Reversals have often been signalled by the refusal of one Average to confirm the penetration of the other." But nothing in Dow's Theory at that time could attest to the fact that the trend had turned up.



In the present situation, Rails confirmed Industrials by bettering the 146.56 level, following which both Averages declined. Subsequently, Industrials rose to an all-time high, but as yet Rails have not confirmed the new Industrial peak (to do this they would have to better 150.81 at point S). Despite this non-confirmation, the primary and secondary trend are considered to remain bullish. And although the Rail action has been undeniably poor, the most that bears can say at this time is that the lack of Rail confirmation is a negative factor in the price structure. Perhaps (in retrospect) they will be able to point to the Rail non-confirmation and say that this was the first hint of impending danger. Bulls, of course, can argue that the last confirmed trend was up, and that an established trend is taken to continue until proved otherwise.

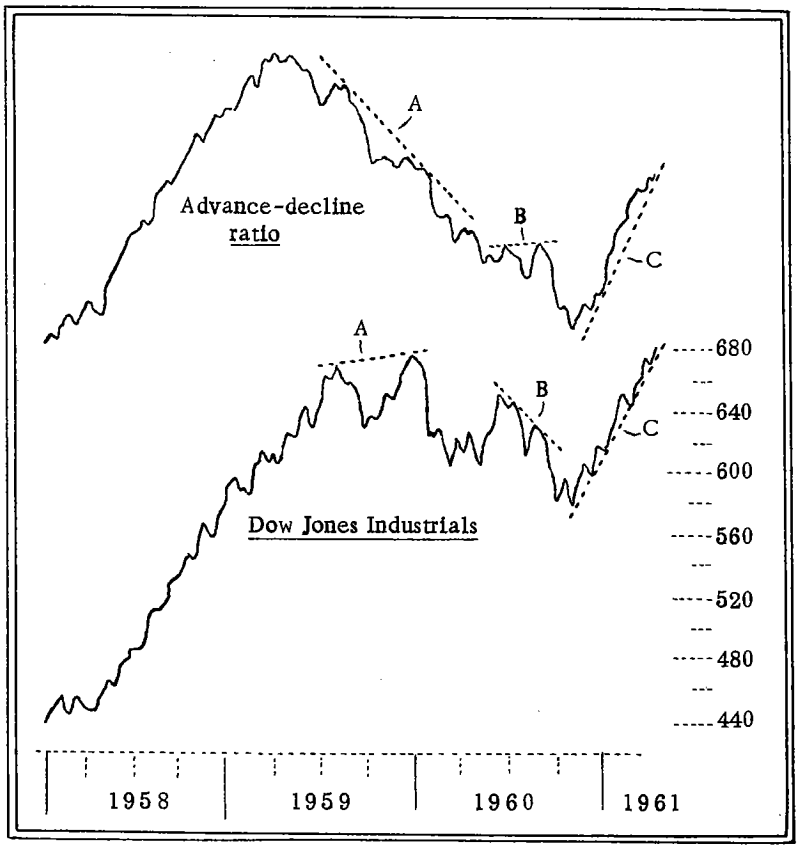
One of the great cases of non-confirmation occurred during the bull market of 1932-37, and I believe this case is worth examining (see chart). The "A" points on the chart mark the peak of the last secondary (upward) reaction of the 1929-32 bear market. Following the A points both Averages declined to their final lows of July 13, 1932. The surge to the B points fell short of the earlier secondary reaction peaks at A. If the rally to B had bettered the previous secondary highs at A, a bull market would have been signalled in the same manner as the current bull market was signalled -- namely, by a straight-line advance which hurdled the preceding secondary peaks.

Following B a normal reaction took place, and when the next advance succeeded in bettering the B points, a bull market was signalled in the orthodox manner. In mid-1933 a reaction occurred, but a new advance took Industrials to an unconfirmed high in 1934. A second reaction took place, and by August of 1934 (at D) Rails had dropped below their 1933 reaction low. Industrials failed by 3.09 points to confirm! Had Industrials confirmed by violating their comparable 1933 low a bear market would have been signalled. Because Industrials refused to confirm the bearish Rail penetration, Rhea (writing at the time) insisted that the primary trend remained bullish. From the D lows Industrials rose almost steadily throughout 1935, 1936 and early 1937. During most of this advance Rails confirmed in direction, but it was not until October, 1936 (at F) that Rails confirmed in a primary sense by bettering the old 1933 high at C. In the opinion of this writer the 1934 Industrial non-confirmation at D remains as one of the great dramatic moments in stock market history.

THE ADVANCE-DECLINE RATIO (A-D ratio) is one of the more important and trustworthy technical indicators; it has a record going back to 1926. A study of the 35 year history of this indicator suggests that when important market tops are reached, the A-D ratio will provide advance notice.

Bull markets frequently "top out" with a last speculative surge in the blue-chip indices (such as the D-J Industrial Average). Since the A-D ratio is representative of the combine movements of all stocks on the Exchange, it is obvious that this ratio will not participate in a final blue-chip "blow-off". Because this type of divergence has occurred at so many important peaks in the past, there is at least a reasonable expectation that it will occur again at the next major top (historically the A-D ratio turns down two or more weeks before

the final reversal in the D-J Industrial Average).



Referring to the chart, we see that a peak was established by the A-D ratio in March 1959, followed by a steady decline in that index. This meant that the broad market was slowly sinking, but despite this the D-J Industrial Average advanced to a new high in August, 1959 (678.10), and a second all-time high in January, 1960 (685.47). The ascending trendline (A) formed by the D-J Industrial Average was in dramatic contrast to the descending trendline (A) traced by the A-D ratio, and the situation was obviously dangerous.

In August, 1960, the A-D ratio bettered its June high, thus forming the ascending trendline market B. This was in contrast to the descending trendline (B) formed by the Industrial Average, and the divergence meant that the general market was now out-performing the D-J Industrials. Although this performance was followed by new lows in both indicators, those lows represented the final bottom of the bear market.

The explosive move which began in late 1960 has continued to the present. During this advance (trendline C) both the A-D ratio and the D-J Industrial Average have been very much in gear. Since March the A-D ratio seems to have lost a good deal of its momemtum, and it now has the appearance of a possible "rounding over". This could be the first sign of weakness in the general market, and it will be commented upon in the next Letter.

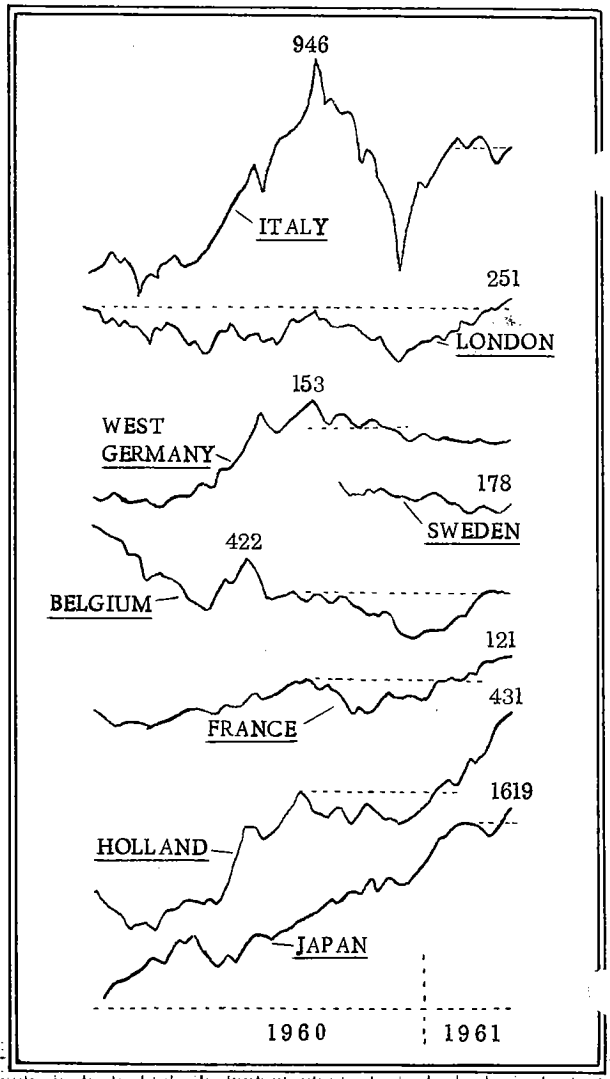
INTERNATIONAL MARKETS In Letter 134 (February 20) I drew attention to the fact that the Dutch Market had risen to new highs, and that the Japanese market was also careening into new high ground. Since primary movements are almost always international in scope, the new highs in Japan and Holland could only be taken constructively.

In early April the British market bettered its January, 1960 peak, and it has since advanced to a record high. France has joined the "new high parade", and Holland has continued to rise week after week.

With this Letter I have added Sweden's stock average, and here we see a rather dragging decline, but no sign of important downside momentum. Belgium has come well off its lows and has been moving higher throughout 1961. Italy's stock index, having literally cut itself in half in 1960, has now regained about 50% of its losses. West Germany's stock average has formed a "line", and a small movement in either direction would probably develop considerable "follow-through".

A most interesting letter has been received (April 3) from Mr. J. F. Danson of England. This correspondent is perhaps the most knowledgeable student of the British market, and he has developed his own "D" Index of cyclical stocks which he uses as a confirmatory average (in lieu of the nationalized British rails). He writes: "The Industrial index has broken above the bull

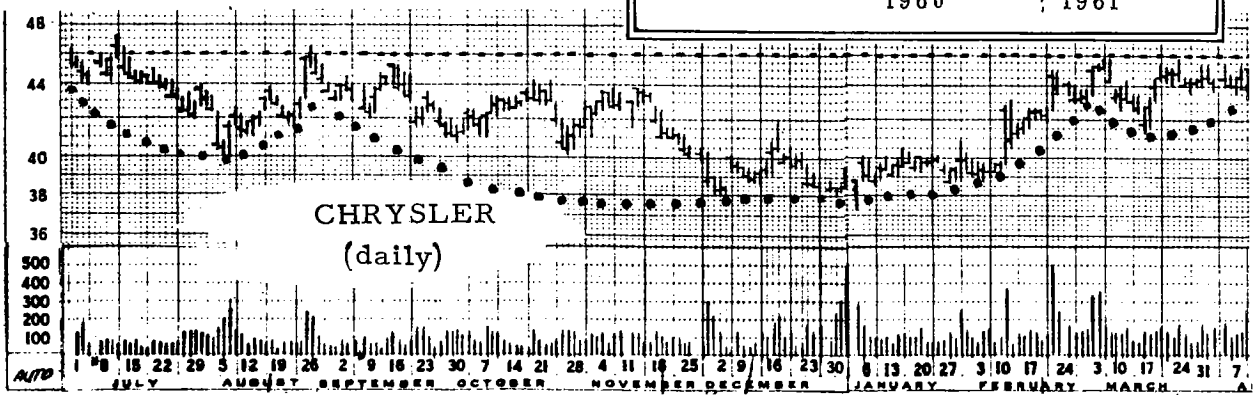
market high of January 4, 1960 (342.9), but the D index is not yet even above the high point of the last primary leg of the bear market (which was August 23, 1960). So no bull market has been signalled by Dow Theory over here. The steady and continuous rally of the last three months looks much more like a primary leg in a bull market than the usual sharp rise of a bear secondary, but until a bull signal is given by Dow Theory, we cannot call a bull market in London. The D index nearly always leads the Industrials except at the major turns, and its lagging behind so far has a rather ominous look."



STOCKS Gold stocks have been hit with a variety of adverse news, and the current consensus is that the balance of payments problem has been "solved". In the face of this the golds have not acted too badly, and it is the opinion of this writer that (1) the greatest part of the decline in the gold stocks is over, (2) that golds are worth accumulating here if for no other reason than that they are on a yield basis.

The charts of the two Canadian gold stocks, Madsen and Bralorne, are included through the courtesy of my friend Iain Fraser of 159 Bay St. Toronto 1, Canada. Mr. Fraser has a number of excellent services including one which deals exclusively with the gold stocks. Madsen has declined on contracting volume, may well have formed a double bottom and is in a buying range. The stock pays a dividend of 20¢ which means that it is now on a 7.4% yield. Bralorne has acted extremely well, volume has contracted sharply on the 1960-61 decline, and with a 40¢ dividend the stock yields 6.4%. In view of their recent declines and the fact that they are now on an excellent yield basis, I believe these two stocks can be included in most portfolios.

As seen on the daily chart, Chrysler has traced a nine-month base in the form of a head-and-shoulders reversal. The stock would appear to be "a buy" at the market.



(Written: Sunday April 16th.)